

**PRIVATE SECTOR DEVELOPMENT OF HOUSING
EASTERN EUROPE**

**CONSTRUCTION LENDING WORKSHOP
MAY 24 – JUNE 8, 1993**

Prepared for

**U.S. Agency for International Development
Bureau for Private Enterprise
Office of Housing and Urban Programs**

November 1993

TRIP REPORT

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Prepared by

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Contract No. EUR-0034-C-00-2032-00, RFS 22

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PADCO
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2 OVERVIEW

The USAID Office of Housing issued a Request for Services (RFS) entitled *Construction Finance Workshop & Initial TA/Training Program* under the Eastern Europe Private Development of Housing Contract with PADCO on 25 March 1993.

The Workshop and TA/Training activities were undertaken by: Howard Henward, Senior Housing Specialist and Team Leader; William Mawhinney, Construction Finance Specialist; Edward Marchant, Real Estate Development Specialist; and James Lynch, Housing Finance Specialist. The Team was assisted by Maya Koleva, Economist, MTK Consult. All work was undertaken in Sofia, commencing 23 May 1993 and ending 8 June 1993.

The Workshop proved to be highly successful and was attended by approximately 40 persons, half of whom represented banking institutions and the other half represented private residential developers and contractors. Mr. Hristo Totev, Minister of Territorial Development and Construction (MTDC), and Mr. Mileti Mladenov, Deputy Governor of the Bulgarian National Bank, delivered the Opening Address. The Workshop was featured on national television and interviews of the instructors and participants were conducted by Bulgarian radio stations and the Workshop was written up by the press.

4 SCOPE OF WORK

The primary purpose of this RFS was to conduct a Construction Finance Workshop aimed at introducing private developers, contractors and bankers to the principles, requirements and techniques of construction lending. The lack of construction loans in Bulgaria represents one of the key impediments to developing new housing and rehabilitating the existing stock.

The Workshop was conducted from 31 May through 4 June at the National Palace of Culture in Sofia; the consultant team spent the week prior to the workshop reviewing and

preparing local case studies to be used in the Workshop. Day 1 of the Workshop consisted of a thorough introduction to construction lending, including such topics as valuation, loan underwriting, disbursement schedules and risk analysis. Day 2 was used to review and discuss a series of case studies (prepared by local developers) which highlighted how construction lending might be applied and illustrated potential advantages, disadvantages and risks of construction loans for developers as well as bankers. Days 3 through 5 were devoted to one-on-one consultation sessions whereby the Workshop instructors met with each development company and banking institution individually to discuss construction lending opportunities and constraints in Bulgaria. The complete Workshop Agenda, including handouts and case studies, is included as an attachment to this report.

In addition to the Workshop, another objective of the RFS was to initiate the development of a longer-term relationship with the Bulgarian private housing development sector. As part of this effort, the consultant team used the occasion of the Construction Finance Workshop to develop a proposed agenda with the Bulgarian Building and Construction Chamber (BBCC) to provide assistance to developers and builders and help promote the private sector development of housing in Bulgaria. This agenda is outlined in the *Recommended Next Steps* section of this report.

6 FINDINGS AND ISSUES

6.2 Findings

One important outcome of the Workshop was a consensus view of the need to move forward immediately with a program aimed at providing banks with the requisite training and technical assistance to begin construction lending. The development and sale of housing units in Bulgaria is expanding and proceeding on the basis of land exchanges and cash sales; however, the market is constrained by the availability of land for exchange and the narrow segment of households with sufficient savings to purchase units for cash. Although construction lending in Bulgaria would initially consist of relatively low loan-to-value loans until interest rates come down, these loans would allow developers to procure necessary construction materials in advance and finish construction on a timely basis without having to make additional concessions to home buyers and land owners.

For the banks, construction loans represent an excellent “springboard” for adopting and institutionalizing a mortgage lending program. USAID has already provided substantial technical assistance and training to the State Savings Bank (SSB) and the Bulgarian Post Bank (BPB) to develop and institutionalize a residential mortgage lending program in Bulgaria; however, given the high interest rates, the banks are hesitant to issue long-term, indexed mortgage instruments. Feedback received from the banking representatives who attended the Workshop suggests that the banks are very anxious to move ahead with short-term construction lending. Focusing on construction finance has the following advantages:

1. It is demand driven; USAID would not be pushing the banks into an area that they believe is premature;

2. The systems and procedures that banks would adopt for construction lending are largely transferable to longer-term lending;
3. Much of the earlier TA work feeds into the construction lending process; in fact, the banks' interest and enthusiasm to begin construction lending programs might largely be attributable to previous TA efforts;
4. Assistance in the area of construction lending can be linked to the training which will be provided to developers (i.e., assistance to developers in preparing financial analyses as well as construction loan applications);
5. Linking the work with developer training activities would permit the regional dissemination of USAID's efforts (i.e., developer training would be conducted through the BBCC's regional offices and this can be linked to bank branches in secondary cities).

6.4 Issues

Another important outcome of the Workshop was the collective identification of issues that need to be addressed in order for construction lending in Bulgaria to become a reality. These issues were classified as bank-, developer-, municipal- and MTDC-specific as well as “joint” issues (i.e., issues that affect all parties). A summary of the key issues discussed during the Workshop is presented below:

Joint Issues

1. **High Inflation and Interest Rates.** With annual interest rates in excess of 50%, the cost and risk of borrowing, even on a short-term basis, is not feasible for developers who can pre-sell units and pass the interest carrying costs on to the homebuyer.
2. **National Taxation Policies for Real Property.** Bulgaria's taxation policies for real property are under revision which, until finalized, creates an “uncertain” environment concerning the tax implications of owning, transferring or developing real estate.
3. **National Housing Policies.** The MTDC is currently drafting new National Housing Policies which could create incentives for the development or rehabilitation of owner- or renter-occupied housing.
4. **Land Valuation.** Land markets in Bulgaria are in a state of gestation and “true” land values will not be realized until issues regarding the transfer of large holdings of state- and municipally-owned land are resolved at the national level.

Bank Issues

1. **Underwriting Procedures.** Banks require technical assistance and training in the areas of project feasibility analysis, risk analysis and market analysis; loan underwriting, documentation and application procedures require some standardization across the banking industry.
2. **Legal Framework.** A legal framework needs to be in place to address issues such as foreclosure, bankruptcy, property title, lien laws and so on.
3. **Appraisal.** Bulgaria has no standardized, regulated appraisal system for land or real property and banks would typically require independent assessments of value for projects eligible for construction loans.
4. **Institutional Requirements.** Banks need to assess their own institutional needs associated with construction lending, such as trained personnel, computer equipment, capital reserves and so on.

Developer Issues

1. **Project Feasibility Analysis.** Most developers in Bulgaria use the “back of the envelope” technique to assess the income or profit potential of a project; developers would benefit from an introduction to the use and application of discounted cash flow analysis for project feasibility assessment.
2. **Loan Applications.** Banks will require detailed financial information from developers requesting construction loans and developers will need to anticipate these requirements to ensure that loan applications are prepared and processed in a timely manner.
3. **Liability.** The personal liability of developers who default on construction loans needs to be explicit, both legally and in the construction loan application itself.

Municipal Issues

1. **Land Valuation.** Baseline values of municipally-owned land need to be established before municipalities can sell- or auction-off their holdings for reasonable compensation.
2. **Property Disposition.** Fundamental policies, regulations and guidelines need to be established to allow municipalities to dispose of property holdings in a prudent manner.
3. **Housing Provision.** Municipalities are still responsible for providing housing to households who were on the housing “waiting list” prior to democratic reforms; however, municipalities lack the financial resources to provide this housing and

whether revenues from municipal land sales can be used for this purpose has yet to be determined.

4. **Infrastructure.** Municipalities lack the financial resources to repair existing infrastructure and to develop new infrastructure to accommodate additional housing; additional sources of revenue to support existing and new infrastructure need to be explored.

MTDC Issues

1. **National Housing Policies.** Although the MTDC has proposed a number of legislative initiatives to support the development of affordable housing, parliament has not reviewed these initiatives nor has it addressed the need for a national housing policy agenda.
2. **Supportive Role.** The MTDC needs to carve out its role in supporting banks, developers and municipalities in advocating a market-oriented housing finance system that supports (and removes impediments to) the private development of housing in Bulgaria.

8 RECOMMENDED NEXT STEPS

8.2 Working Committee

An important outcome of the Construction Finance Workshop was a consensus of the need to establish a Working Committee consisting of representatives from the BBCC (representing developers and contractors), banking institutions, the Ministry of Construction and municipalities. Minister Totev, in fact, announced the formation of this committee to the press at the wrap-up meeting on June 8th. The initial focus of this Committee would be to address the issues identified at the Workshop that are impacting construction lending in Bulgaria. However, on the medium term agenda of the committee would be consideration of options for developing mortgage lending, either through existing or new banking institutions and with or without some form of secondary market.

The BBCC has agreed to initiate the formation of such a committee and, per our discussions, the BBCC would:

1. **Contact prospective Committee members and inform PADCO as to who has agreed to participate and their respective affiliations;**
2. **Attempt to convene an initial Committee meeting in late July in order to outline the Committee's mission and objectives;**
3. **Assist in the designation of a Committee Chairperson who would be responsible for moderating Committee meetings and reporting significant issues raised by Committee members.**

It is expected that the Committee would meet on a regular basis (perhaps once a month) after the summer vacation season. The BBCC has requested that ongoing assistance from AID/PADCO be provided to the committee.

8.4 Technical Assistance to the Banking Sector

Proposed TA

Meetings were held with The Minister during the week following the Workshop to discuss proposals for future work. The Minister is very enthusiastic about moving ahead with a program to provide banks with the requisite technical assistance to develop their internal capabilities to underwrite, issue and service construction loans for residential development projects.

Clients

We are proposing to focus this work in three banks: The State Savings Bank (SSB); The Bulgarian Post Bank (BPB); and The United Bulgarian Bank (UBB). The first two banks were clients for the mortgage lending program and they are anxious to receive assistance.

The SSB has already issued one construction loan for a private project (the project and the loan are in serious trouble), and the bank wants to increase and improve its activity in this area and avoid earlier mistakes. After hearing one of the developers speak during the conference, the First Vice President of the SSB asked the developer if he would be interested in a construction loan for the project. Despite the hesitation over a pilot long-term mortgage project, the SSB is very interested in construction lending and has hired a new staff member to be a full-time counterpart for USAID TA.

The BPB has publicly stated that it is looking for developer customers and is willing to begin issuing construction loans immediately. The bank recently created a new housing finance department; the Chief Credit Officer participated actively in the Workshop and she stated that she is anxious to receive TA to support and refine their initial efforts in this area. This desire for TA was subsequently supported by both the Bank's President and a recent policy statement from the Bank's Board of Directors.

The UBB is the result of a recent merger of twenty banks, including the former Construction Bank. It is now one of the country's strongest banks and the EBRD is currently considering investing in the institution. Amongst all banks, the UBB was the most aggressive in seeing that they be included in future TA efforts. The Bank emphasized that it sees its long-term role as including housing finance and they want to begin construction lending in the near future. Three of the Bank's senior staff attended the entire Workshop and the Bank's Chief Executive Director made two visits--he also participated in the debriefing session with The Minister.

A number of other banks also expressed interest, particularly a new private bank, The Credit Bank, but none of these banks are as far along in their planning as the three banks

above. These other banks will, however, provide an audience for the dissemination of work with the three initial clients.

Proposed TA Structure

It is proposed that PADCO place a mid-term (4 to 5 month) advisor in each of these three banks. These advisors would be senior bankers with broad experience, but also with specific expertise in construction lending. Each advisor would work with their respective bank on a daily basis to develop and implement construction lending systems and procedures and, using pilot projects, guide each bank through their initial loans.

The advisors would also identify areas where additional training efforts would be needed and these efforts would be conducted on a multi-bank basis (i.e., other banks would be encouraged to participate as well). Furthermore, this work would be linked to developer training activities to be conducted through the Bulgarian Building and Construction Chamber (BBCC) and its regional offices. Training activities would include, but not be limited to, the preparation of financial feasibility studies and construction loan applications as well as the implementation of construction and cost management programs. A Memorandum of Understanding between the BBCC and PADCO is being prepared and proposed technical assistance programs are scheduled to begin this Fall.

The first step toward implementing this proposed TA program is to send one advisor to meet with each of the three banks individually to map out a detailed TA program tailored to the needs of the respective banks. It is envisioned that this would could take place in July and would last approximately four weeks--one week at each bank and one week of follow-up activities. This advisor would also be responsible for drafting the detailed SOWs for the three short-term bank advisors.

8.6 Technical Assistance to the Private Development Sector

Areas of Assistance

As discussed, the BBCC will assist PADCO in identifying priority areas of technical assistance to the private real estate development sector in Bulgaria. PADCO's report prepared in January 1993, *Proposed Strategy for Technical Assistance to Trade and Professional Associations in Bulgaria's Private Housing Sector*, identified 12 areas of proposed technical assistance and training to real estate developers and contractors.

PADCO and the BBCC discussed, in broad terms, the need for training in the areas of financial analysis, project management and marketing. The BBCC agreed to identify priority areas of assistance and submit a list to PADCO which would also include a brief description of the subject matter to be emphasized. It is envisioned that this technical assistance would be delivered in Workshop format in different regions across Bulgaria.

Priority Cities

The BBCC offered to identify priority cities for Training Workshops as well as potential demonstration projects. It was recommended that the BBCC contact MTK Konsult in Sofia to learn which cities are targeted for USAID-sponsored assistance programs and the nature of this assistance. This information would possibly lead to potential areas of collaboration among the BBCC, municipal officials, local banking institutions and USAID contractors.

Computer Equipment for the BBCC

The BBCC provided PADCO with a list of computer equipment that is required by the Chamber's regional offices to support a compressive real estate information network. PADCO will deliver this request to USAID and keep the BBCC informed of USAID's decision.

Local Support

PADCO plans to hire a local counterpart who could assist the BBCC in many of the activities outlined above. This local counterpart would work through MTK Konsult and could serve as an important liaison between the BBCC and PADCO.

10 LIST OF ATTACHMENTS

- 1. Schedule of Daily Activities**
- 2. Construction Lending Workshop Materials**
 - a. Workshop Agenda**
 - b. List of Participants**
 - c. Workshop Handouts**
 - d. Case Studies**
- 3. FAX Transmittal to USAID**
- 4. Memorandum of Understanding to the BBCC**

ATTACHMENT 1

SCHEDULE OF DAILY ACTIVITIES

Monday, May 24

PM: *Arrival in Sofia*

- **James Lynch, PADCO**
- **Ed Marchant, PADCO**
- **Bill Mawhinney, PADCO**

Tuesday, May 25

AM: *Briefing Meeting with:*

- **Michael Hoffman, UI**
- **Maya Koleva, MTK Konsult**

Meeting with Local Developer:

- **Konstantin Kazakov, President
Building Association Company**

PM: *Discussed Workshop & Reviewed Materials*

Wednesday, May 26

AM: *Prepared Lozenets Case Study*

PM: *Prepared Lozenets Case Study*

Thursday, May 27

AM: *Meeting with Local Developer:*

- **Ilia Chonev, President**
- **Violeta Choneva, Vice President
InvestProject 90**

PM: *Meeting at the State Savings Bank:*

- **Bistra Dimitrova, Head of the Housing Branch in Sofia**

Friday, May 28

AM: *Meeting with Local Developer:*

- **Petko Petkov, President**
 Talasakra Company
- **Dimitar Doukov, Expert**
 MTDC

PM: *Arrival in Sofia*

- **Howard Henward, PADCO**

Inspect Conference Facilities

Saturday, May 29

AM: *Visit Housing Development Site*

PM: *Workshop Preparation*

Sunday, May 30

AM: *Workshop Preparation*

PM: *Assemble Workshop Materials*

Monday, May 31

Day #1 of Workshop (see Agenda)

Tuesday, June 1

Day #2 of Workshop (see Agenda)

Wednesday, June 2

AM: *Day #3 of Workshop (Discussion of Issues)*

PM: *Meetings with Developers:*

- **Konglomerat**
- **Talasakra**
- **Sprint**
- **Kolarov + Vagner**

Meetings with Bankers:

- **Post Bank**
- **Credit Bank**

Thursday, June 3

AM: *Day #4 of Workshop—Meetings with Developers:*

- **InvestProject 90**
- **Marpex**
- **ABC Engineering**

PM: *Meetings with Developers:*

- **Bigla + Gradina**
- **Losenetz**
- **RDP**

Meetings with Bankers:

- **United Bulgarian Bank**
- **State Savings Bank**

Meeting at the Bulgarian American Enterprise Fund:

- **Virginia Rollins, Investment Officer**

Friday, June 4

AM: *Day #5 of Workshop—Roundtable Discussion with Bakers and Developers*

PM: *Prepare for Meetings with USAID and the MTDC*

Saturday, June 5

AM: *Depart from Sofia*

- **Ed Marchant, PADCO**
- **Bill Mawhinney, PADCO**

Meeting with the BBCC:

- **Dimo Gugutchkov, President**
- **Theodore Shishmanov, Consultant**

Monday, June 7

AM: *Meeting with the BBCC:*

- **Dimo Gugutchkov, President**
- **Theodore Shishmanov, Consultant**

PM: *Meeting with the MTDC:*

- **Hristo Totev, Minister MTDC**
- **Daniel Leviev, Deputy Minister of MTDC**
- **Galina Guirova, Head of International Department, MTDC**

Tuesday, June 8

AM: *Meeting with the BBCC:*

- **Dimo Gugutchkov, President**
- **Theodore Shishmanov, Consultant**

PM: *Debriefing with USAID:*

- **Gerald Zarr, USAID Representative**
- **John Babylon, Deputy to the Representative**

Meeting at the MTDC and Press Conference

- **Hristo Totev, Minister MTDC**
- **Daniel Leviev, Deputy Minister of MTDC**
- **Galina Guirova, Head of International Department, MTDC**
- **Mileti Mladenov, Deputy Governor of the Bulgarian National Bank**
- **Dimitar Dimitrov, Executive Director of the United Bulgarian Bank**
- **Oleg Nedjalkov, Executive Director of the United Bulgarian Bank**
- **Georgi Tomov, Vice President of the State Savings Bank**
- **Vanja Vassileva, Executive Director of the Bulgarian Post Bank**
- **Bistra Ilkova, Director, Credit Department, Bulgarian Post Bank**
- **Milcho Guirov, Consultant to the Urban Institute, Housing Finance**
- **Dimo Gugutchkov, Chairman, Bulgarian Building and Construction Chamber**
- **Theodore Shismanov, Consultant to the BBCC**

Wednesday, June 9

AM: *Depart from Sofia*

- **Howard Henward, PADCO**
- **James Lynch, PADCO**